OPEN MEETING AGENDA ITEM

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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF JOHNSON UTILITIES, LLC, DBA JOHNSON UTILITIES COMPANY FOR AN INCREASE IN ITS WATER AND WASTEWATER RATES FOR CUSTOMERS WITHIN PINAL COUNTY, ARIZONA.

DOCKET NO. WS-02987A-08-0180

STATUS REPORT REGARDING CAGRD ADJUSTER MECHANISM AND COMMENTS REGARDING STAFF'S SECOND SUPPLEMENTAL MEMORANDUM

On November 19, 2010, Johnson Utilities LLC ("Johnson Utilities" or the "Company") docketed a status report regarding the Central Arizona Groundwater Replenishment District ("CAGRD") adjustor mechanism that was approved by the Arizona Corporation Commission ("Commission") in Decision 71854. In the status report, Johnson Utilities advised the Commission that there have been ongoing discussions between Utilities Division Staff ("Staff"), the Central Arizona Water Conservation District ("CAWCD") and the Arizona Department of Water Resources ("ADWR") regarding the replenishment taxes payable by Johnson Utilities to the CAGRD. CAWCD and ADWR have previously reached an understanding that all excess groundwater pumped by a designated provider such as Johnson Utilities is subject to the replenishment tax. However, Staff raised a question regarding whether the replenishment obligation applies to all groundwater pumped, which is the position of CAGRD and ADWR, or only to groundwater delivered to customers. This question is discussed in Staff's Second Supplemental Memorandum ("Second Supplemental Staff Memo") dated December 10, 2010.

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On December 8, 2010, Johnson Utilities coordinated a meeting at the Commission among Utilities Division Director Steve Olea and other members of Staff, Cliff Neal (Manager, Planning and Replenishment, CAWCD) and other representative of the Central Arizona Project ("CAP"), Doug Dunham (Manager, Assured & Adequate Water Supply Programs, Water Management Division, ADWR), Dan Pozefsky and Bill Rigsby of the Residential Utility Consumer Office ("RUCO"), and representatives of Johnson Utilities, including Mike Pearce, the former Chief Counsel to ADWR. At that meeting, Messrs. Dunham, Neal and Pearce provided information to Staff regarding the designation of assured water supply program and the calculation of the CAGRD replenishment tax. In addition to the information contained in the Second Supplemental Staff Memo, Johnson Utilities believes that it may be helpful to the Commission to have a brief summary regarding water management for designated water providers Arizona, based upon information provided by Messrs. Dunham, Neal and Pearce.

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<u>Water Management for Designated Water Providers in Arizona</u>.

Arizona's water management regime under the Assured Water Supply Program requires that all subdivided land in an Active Management Area ("AMA") obtain a determination of assured water supply, either by the developer obtaining a Certificate of Assured Supply ("CAWS") or by the developer obtaining service from a water provider (a "Designated Provider") which holds a Designation of Assured Supply ("DAWS"). Either approach requires that the water supply be "consistent with the management goal" of the AMA. This means that the water supply must either be largely non-groundwater, or that groundwater use beyond a certain volume (the "groundwater allowance") be replenished by the CAGRD.

Arizona water policy favors the creation of Designated Providers—of which Johnson Utilities is one—and the use of DAWS, which greatly facilitates the management of the assured water supply program and the administration of replenishment obligations. There are several important benefits of DAWS. Designated Providers have greater flexibility to move water around within their service areas, and to use a wider variety of water types (effluent, groundwater, surface water or Colorado River water) within their portfolios, leading to greater efficiency, better conservation, better economies of scale, greater development potential and greater use of recycled water. CAWS, by comparison, are typically based 100% on groundwater, with consistency with the management goal being demonstrated exclusively through CAGRD replenishment. In addition, Designated Providers can use Central Arizona Project ("CAP") water to recharge aquifers and accrue long term storage credits, without having to first offset groundwater withdrawals, thereby providing a significant incentive for the use of this renewable water supply. DAWS also better facilitate the entitlement process for new subdivisions, as they permit new service without further hydrologic proof of physical availability or consistency with the management goal by the developer. There are enrollment fees and reserve fees associated with CAWS that add approximately $138 to the cost of a house, and these fees are increasing every year. When added to the homeowner's mortgage at an assumed interest rate of 5%, this would add over $6.90 per year in additional mortgage expense to each homeowner, and this does not include the cost of the CAWS studies that are required and provided to ADWR to obtain certificate approval, which cost is also added to the cost of the home. This is certainly more expensive than the estimated $5.38 of additional cost associated with lost and unaccounted for water that the average homeowner would pay in a year in Johnson Utilities' service area. Thus, a DAWS actually provides savings over a CAWS that can be passed along to the homeowner.

However, with greater flexibility for Designated Providers comes additional responsibilities. First, a Designated Provider is solely responsible for maintaining its assured water supply. If it does not have sufficient non-groundwater sources to meet its demand, it must use groundwater and then replenish that groundwater through the CAGRD. To accomplish this, the Designated Provider must become a Member Service Area ("MSA") and enter into a binding MSA agreement, which specifies exactly how much of the groundwater used must be replenished by CAGRD in any given year.

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Second, the Designated Provider must report its current, committed and projected demand to ADWR each year, and ADWR closely monitors the accuracy of these reports to insure that the provider is both in short-term compliance and has sufficient water resources within its portfolio to allow at least two years of future anticipated growth. If the Designated Provider cannot meet these standards, the DAWS can be revoked. In addition, the DAWS is frequently reviewed by ADWR (in 10 or 20 year intervals) to insure that all elements of the assured supply continue to be met, whereas a CAWS is based upon a one-time review. Once a DAWS is issued for a service area, a CAWS can no longer be issued in that service area.[1]

A DAWS is unique to each Designated Provider. It is based on many factors, including the historical use of water within the service area, the AMA in which the Designated Provider is located, and the types of water in the Designated Provider's portfolio. A critical element of any DAWS is the unique groundwater allowance granted to the Designated Provider. This allowance may be comprised of many elements, including historic groundwater usage, incidental recharge credit, credits earned from the permanent extinguishment of grandfathered groundwater rights, and certain allowances unique to the AMA. Thus, the amount of groundwater that a Designated Provider must replenish through the CAGRD is also unique to the provider, and this amount is defined as "excess groundwater" under Arizona's water management laws. See A.R.S. § 48-3701(7) (definition of "excess groundwater"). In other words, there will be differences in the replenishment obligations (and associated costs) of different Designated Providers under their respective DAWS.

Within the CAGRD regime, Designated Providers themselves are unique. The individual MSA agreements have evolved over the years and must be custom-tailored to

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[1] For this reason, Johnson Utilities takes issue with the last paragraph of the Second Supplemental Staff Memo which states that the Commission can approve CAGRD adjuster rates in this case that are based upon excess groundwater delivered and not groundwater pumped. Johnson Utilities is invoiced by CAGRD based on excess groundwater pumped, and the Company will always be invoiced this way under its DAWS for the customers that are covered under its DAWS. Thus, if the Commission approves CAGRD adjuster rates that are based on excess groundwater delivered, Johnson Utilities will substantially under-recover its CAGRD expense going forward. This issue is addressed further below.

the AMA in which the Designated Provider is located. Johnson Utilities, for example, has two MSA agreements, because the Company provides service in both the Phoenix AMA and the Pinal AMA. ADWR required—and CAGRD issued—a separate agreement for each AMA. Thus, even within a single Designated Provider, the specific terms of the replenishment obligations (and associated costs) may vary according to the location of the service area, as is the case with the two separate CAGRD adjuster calculations for the Phoenix AMA and Pinal AMA portions of Johnson Utilities' service area.

It should also be noted that a critical distinction is made between lands served by a Designated Provider and lands subdivided under a CAWS by both ADWR and CAGRD, based on the specific wording of the statute defining "excess groundwater." The definition states that excess groundwater is water "delivered to a member [CAWS] land ... or delivered within a member service area...." Based on this definition, ADWR maintains that a Designated Provider must replenish all excess groundwater withdrawn by the Designated Provider, while individual member (*i.e.*, CAWS) lands are only required to replenish water delivered to their individual lands. Both ADWR and CAGRD have adhered to this distinction consistently over the last several years, and <u>all</u> Designated Providers that are member service areas report their replenishment obligation to ADWR and CAGRD based on groundwater <u>pumped</u>, rather than groundwater delivered. ADWR maintains that this distinction is consistent with the overall water management regimen that allows Designated Providers greater flexibility, but requires that each Designated Provider maintain its entire assured water supply consistent with the achievement of the management goal.

<u>Conservation of Groundwater Resources</u>.

There is likely a CAGRD replenishment cost difference between lands served under a DAWS and lands served under a CAWS. This cost difference, very much like the differences in costs between renewable energy supplies and traditional energy supplies as discussed below, is based upon sound principles of water management and

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sustainability. However, costs differences should not deter the Commission from adopting CAGRD adjuster mechanisms because the use of DAWS represents perhaps the greatest opportunity to make better use of recycled water, spot-market CAP water and remediated groundwater in Arizona. Use of any of these alternatives reduces the use of potable groundwater and furthers Arizona's goal of achieving long-term safe yield in the safe yield AMAs.

The CAGRD adjuster approved by the Commission in Decision 71854 goes directly to the heart of this policy. By recognizing the value of DAWS, with their additional obligations, the Commission is recognizing the need to move steadily toward a secure water future for the State's most populated areas. Certainly, designation comes with an acknowledgment that CAGRD replenishment costs (i) will vary between different Designated Providers, (ii) will possibly vary within the areas served by the very same Designated Provider, and (iii) will vary between lands served under a DAWS and lands served under a CAWS. These cost differences are not caused by the Designated Providers, but result from the implementation by ADWR and CAGRD of Arizona's water management policy, which provides for differing costs. The CAGRD adjuster mechanism approved by the Commission in Decision 71854 represents a significant precedent, as well as a prototype, and will determine how this policy will or will not be implemented in future water company rate case proceedings.

Over the past several years, the Commission has adopted policies and made statements that show the level of commitment it expects regulated utilities to make toward water conservation and water management. This has been demonstrated numerous times through the ordering of curtailment tariffs, best management practices, and prohibitions on groundwater for golf course, to name just a few. These things were identified by the Commission as contributing to the overall public policy goal of better management of scares groundwater resources in a desert environment. Likewise, encouraging DAWS also furthers the public policy goal of good groundwater stewardship. It should also be noted that the Commission is not the only regulatory body

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to recognize DAWS as a means to achieving groundwater management. Both ADWR and CAGRD have made clear how important DAWS are to their management objectives.

<u>Analogy to Renewable Energy</u>.

In areas other than groundwater conservation, this Commission has approved orders that further important public policy goals even though ratepayers may be required to pay slightly more for service. The best example of this may be renewable energy. Over the last seven years, the Commission has promulgated rules and adopted orders that require the type and use of renewable energy. In the short run, and setting aside the cost of externalities, this energy is somewhat more expensive to capture than the cost to produce electricity using traditional coal or natural gas. However, the Commission has committed to renewable energy because of the many short-term and long-term benefits to customers and to society generally. This Commission should look at DAWS in the same light.

<u>CAGRD Costs for Customers of Public Utilities in Close Proximity to Johnson Utilities' Service Area</u>.

Johnson Utilities is the only Designated Provider in the immediate vicinity surrounding its service area. However, there are other public utilities in the immediate vicinity and it is instructive to compare the rates that customers of these utilities are charged by CAGRD for replenishment under the applicable CAWS. By way of example, customers of Diversified Water Company pay $0.728 per 1,000 gallons of water delivered (on their property tax bills) and customers in H2O Water Company pay $0.966 per 1,000 gallons of water delivered (on their property tax bills). *See* <u>Attachment 1</u>. These two water companies, which are both located within the Phoenix AMA, do not hold DAWS, so their customers and this State do not receive the public policy benefits of designation discussed above.

In its the Second Supplemental Staff Memo, Staff calculates a CAGRD adjuster rate of $0.0747 per 1,000 gallons based upon groundwater pumped (which promotes the DAWS method). It should be noted that this rate is significantly <u>lower</u> than the rate that

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is charged to customers of H2O Water Company based upon water delivered, and only negligibly higher than the rate charged to customers of Diversified Water Company for water delivered. Thus, it is erroneous for Staff to assert in the third paragraph of the Second Supplemental Staff Memo that "the charge to those customers in a CAWS area is less than those in a DAWS area." In reality, the customers of Johnson Utilities (and the State of Arizona) receive all of the benefits of a DAWS as discussed above but they do not pay more than nearby customers that are covered under CAWS.

In addition, while it may be tempting to compare raw rates for customers served under CAWS and customers served under DAWS, for the reasons discussed above, such a comparison is not an "apples to apples" comparison. For example, the raw CAWS rate does not take into account the substantial amounts that developers pay to register their lands with the CAGRD and to obtain the CAWS itself, as discussed above. These large up-front costs are passed through to the homeowners in the price of the home. In addition, the raw CAWS rate does not take into account the many benefits of DAWS discussed above. Moreover, as shown above, customers obtaining service under a CAWS may in fact pay more than customers served under a DAWS.

Johnson Utilities agrees with Staff that "[i]f the Commission wishes to promote the DAWS method it should approve recovery of all CAGRD feed paid by the provider, i.e., fees related to all excess groundwater pumped." Second Supplemental Staff Report at page 2. Johnson Utilities receives an invoice from CAGRD for the amount of all excess groundwater that is pumped. The quantity of groundwater that is delivered to customers is a smaller number because of factors such as line loss, fire hydrant testing, system flushing and testing, blow off, etc. Thus, if the Commission does not approve the CAGRD adjuster rate based upon excess groundwater pumped, Johnson Utilities will fail to recover a significant portion of its CAGRD expense each and every year. Thus, the Company urges the Commission to adopt the Staff-calculated rate of $0.747 per thousand gallons for customers in the Phoenix AMA and the rate of $0.252 per thousand gallons for customers in the Pinal AMA.

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As applied to Johnson Utilities, the Company disagrees with Staff's statement that "[i]f the Commission wishes to not promote the use of DAWS, but prefers that developers obtain their own CAWS for each subdivision," then the CAGRD adjuster should be based on gallons sold. Second Supplemental Staff Memo at page 2 (emphasis added). Johnson Utilities already holds a DAWS, and the Company will always be assessed by CAGRD based on excess groundwater pumped for the current portion of its customer base that is served under the DAWS. Thus, while approving CAGRD adjuster rates based upon water delivered will certainly discourage water companies from becoming Designated Providers, it would ensure that Johnson Utilities would significantly under-recover its CAGRD expense going forward.

Finally, looking at a DAWS in the same light as this Commission has viewed renewable energy also supports the Company's recovery of all of its CAGRD expense. The state agencies that regulate water have determined that a designation is the best means available to further the public policy goals of water conservation and management.

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June 1 Effective Date for CAGRD Adjustor.

There has been substantial discussion regarding the appropriate effective date of the new CAGRD adjustor rates. Through September 2010, Johnson Utilities has incurred $653,511.19 in CAGRD charges that were offset by the customer credits. If the Commission adopts Staff's recommendation and requires Johnson Utilities to refund the CAGRD adjuster charges since June, it will ultimately result in an additional $0.30 in the CAGRD adjustor rates in 2011 (for customers in the Phoenix AMA) to true-up this shortfall. Thus, a delay in the collection of the CAGRD adjuster rates when they have been accruing every month since June 1, 2010, *will ultimately lead to rate shock in 2011* in the form of an additional $0.30 per thousand gallons for customers in the Phoenix AMA.[2] Thus, Johnson Utilities requests that the Commission adopt the Staff-calculated

[2] Although Johnson Utilities has not included the impact for customers in the Pinal AMA, it would be similar in scale to the impact for customers in the Phoenix AMA.

rate of \$0.747 per thousand gallons for customers in the Phoenix AMA and the rate of \$0.252 per thousand gallons for customers in the Pinal AMA (based upon groundwater pumped), with an effective date of June 1, 2010. Attached hereto as Attachment 2 are comparisons between Johnson Utilities' old rates and new rates for the Phoenix AMA and the Pinal AMA showing the CAGRD adjuster rates.

RESPECTFULLY submitted this 14th day of December, 2010.

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ATTACHMENT "1"

Company	Total Reported Water Delivered in 2009 (AF)	Total Reported Excess Groundwater Delivered in 2009 (AF)	Total CAGRD Assessments for 2009 Pumping	Total Cost per 1,000 gallons Delivered
Diversified Water Company	277.76	185	$65,860	0.728
H2O Water Company	2736.34	2430.36	$861,648	0.966

ATTACHMENT "2"

Johnson Utilities - Water Division - Decision 71854
Bill Comparison between Old and New Rates
Meter Size: 3/4 Inch Residential
Phoenix AMA CAGRD Fee

Usage	Previous Bill	New Bill	CAGRD Tax	Dollar Decrease	Percent Decrease
0	$27.00	$16.50	$0.00	($10.50)	-38.89%
1,000	$29.25	$18.26	$0.75	($10.24)	-35.01%
2,000	$31.50	$20.02	$1.50	($9.98)	-31.68%
3,000	$33.75	$21.78	$2.25	($9.72)	-28.80%
4,000	$36.00	$23.54	$3.00	($9.46)	-26.28%
5,000	$38.25	$25.68	$3.75	($8.82)	-23.06%
6,000	$40.50	$27.82	$4.50	($8.18)	-20.20%
7,000	$42.75	$29.96	$5.25	($7.54)	-17.64%
8,000	$45.25	$32.10	$6.00	($7.15)	-15.80%
9,000	$47.75	$34.24	$6.75	($6.76)	-14.16%
10,000	$50.25	$36.38	$7.50	($6.37)	-12.68%
12,000	$55.25	$41.37	$9.00	($4.88)	-8.83%
14,000	$60.25	$46.36	$10.50	($3.39)	-5.62%
16,000	$65.25	$51.36	$12.00	($1.89)	-2.90%
18,000	$70.25	$56.35	$13.50	($0.40)	-0.57%
20,000	$75.25	$61.34	$15.00	$1.09	1.45%
25,000	$87.75	$73.82	$18.75	$4.82	5.49%
30,000	$100.25	$86.30	$22.50	$8.55	8.53%
35,000	$112.75	$98.78	$26.25	$12.28	10.89%
40,000	$125.25	$111.26	$30.00	$16.01	12.78%
45,000	$137.75	$123.74	$33.75	$19.74	14.33%
50,000	$150.25	$136.22	$37.50	$23.47	15.62%
60,000	$175.25	$161.18	$45.00	$30.93	17.65%
70,000	$200.25	$186.14	$52.50	$38.39	19.17%
80,000	$225.25	$211.10	$60.00	$45.85	20.36%
90,000	$250.25	$236.06	$67.50	$53.31	21.30%
100,000	$275.25	$261.02	$75.00	$60.77	22.08%
Average Usage					
6,931	$42.60	$29.81	$5.20	($7.58)	-17.80%
Median Usage					
6,000	$40.50	$27.82	$4.50	($8.18)	-20.20%

Old Rates:

Monthly Minimum:		$27.00
Gallons in Minimum		0
Charge Per 1,000 Gallons		
Up to	7,000	$2.25
Over	7,000	$2.50

New Rates:

Monthly Minimum:		$16.50
Gallons in Minimum		0
Charge Per 1,000 Gallons		
Up to	4,000.00	$1.760
Up to	10,000.00	$2.140
Over	10,000.00	$2.496

Phoenix AMA CAGRD Fee*
Per 1,000 Gallons $0.75

Johnson Utilities - Water Division - Decision 71854
Bill Comparison between Old and New Rates
Meter Size: 3/4 Inch Residential
Pinal AMA CAGRD Fee

Usage	Previous Bill	New Bill	CAGRD Tax	Dollar Decrease	Percent Decrease
0	$27.00	$16.50	$0.00	($10.50)	-38.89%
1,000	$29.25	$18.26	$0.25	($10.74)	-36.72%
2,000	$31.50	$20.02	$0.50	($10.98)	-34.86%
3,000	$33.75	$21.78	$0.75	($11.22)	-33.24%
4,000	$36.00	$23.54	$1.00	($11.46)	-31.83%
5,000	$38.25	$25.68	$1.25	($11.32)	-29.59%
6,000	$40.50	$27.82	$1.50	($11.18)	-27.60%
7,000	$42.75	$29.96	$1.75	($11.04)	-25.82%
8,000	$45.25	$32.10	$2.00	($11.15)	-24.64%
9,000	$47.75	$34.24	$2.25	($11.26)	-23.58%
10,000	$50.25	$36.38	$2.50	($11.37)	-22.63%
12,000	$55.25	$41.37	$3.00	($10.88)	-19.69%
14,000	$60.25	$46.36	$3.50	($10.39)	-17.24%
16,000	$65.25	$51.36	$4.00	($9.89)	-15.16%
18,000	$70.25	$56.35	$4.50	($9.40)	-13.38%
20,000	$75.25	$61.34	$5.00	($8.91)	-11.84%
25,000	$87.75	$73.82	$6.25	($7.68)	-8.75%
30,000	$100.25	$86.30	$7.50	($6.45)	-6.43%
35,000	$112.75	$98.78	$8.75	($5.22)	-4.63%
40,000	$125.25	$111.26	$10.00	($3.99)	-3.19%
45,000	$137.75	$123.74	$11.25	($2.76)	-2.00%
50,000	$150.25	$136.22	$12.50	($1.53)	-1.02%
60,000	$175.25	$161.18	$15.00	$0.93	0.53%
70,000	$200.25	$186.14	$17.50	$3.39	1.69%
80,000	$225.25	$211.10	$20.00	$5.85	2.60%
90,000	$250.25	$236.06	$22.50	$8.31	3.32%
100,000	$275.25	$261.02	$25.00	$10.77	3.91%

Average Usage					
6,931	$42.60	$29.81	$1.73	($11.05)	-25.94%
Median Usage					
6,000	$40.50	$27.82	$1.50	($11.18)	-27.60%

Old Rates:

Monthly Minimum:		$27.00
Gallons in Minimum		0
Charge Per 1,000 Gallons		
Up to	7,000	$2.25
Over	7,000	$2.50

New Rates:

Monthly Minimum:		$16.50
Gallons in Minimum		0
Charge Per 1,000 Gallons		
Up to	4,000.00	$1.760
Up to	10,000.00	$2.140
Over	10,000.00	$2.496

Pinal AMA CAGRD Fee*	
Per 1,000 Gallons	$0.25